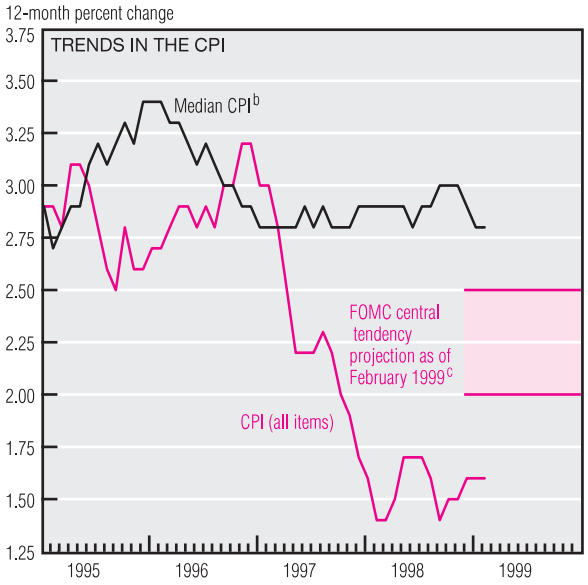
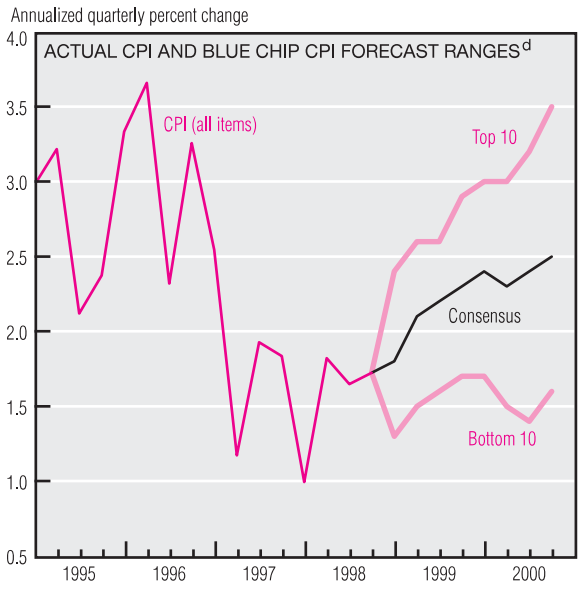
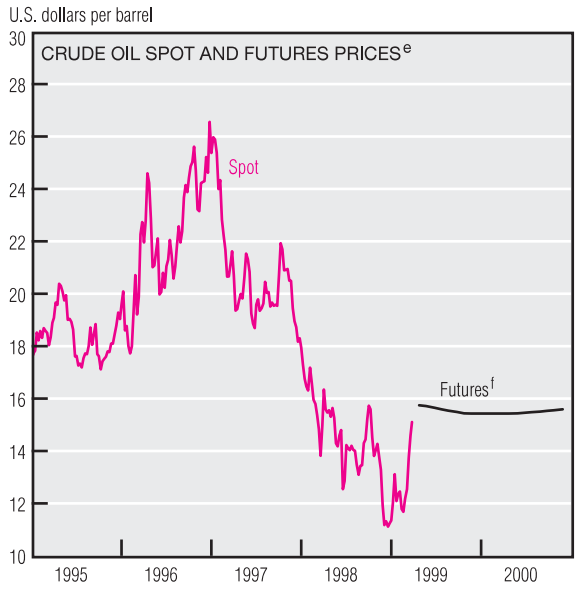
Inflation and Prices

February Price Statistics

	Percent change, last:				
	1 mo.[a]	3 mo.[a]	12 mo.	5 yr.[a]	1998 avg.
Consumer prices					
All items	0.7	1.2	1.6	2.3	1.6
Less food and energy	0.7	1.8	2.1	2.6	2.5
Median[b]	2.2	2.1	2.8	2.9	2.9
Producer prices					
Finished goods	–4.5	2.2	0.6	1.0	–0.2
Less food and energy	0	3.9	2.2	1.3	2.4







a. Annualized.
b. Calculated by the Federal Reserve Bank of Cleveland.
c. Upper and lower bounds for CPI inflation path as implied by the central tendency growth ranges issued by the FOMC and nonvoting Reserve Bank presidents.
d. Blue Chip panel of economists.
e. West Texas intermediate crude oil.
f. Closing price, March 22, 1999.
SOURCES: U.S. Department of Labor, Bureau of Labor Statistics; the Federal Reserve Bank of Cleveland; *Blue Chip Economic Indicators*, March 10, 1999; *Cushing Journal of Commerce;* and the New York Mercantile Exchange.

Prices followed a moderate growth trajectory in February. The Consumer Price Index (CPI) increased an annualized 0.7% during the month, less than its 1.6% average rise over the past 12 months. The Producer Price Index (PPI) fell an annualized 4.5% and is up a mere 0.6% from February 1998.

Most economists expect growth in retail prices to pick up over the course of 1999 and beyond; some even see retail price increases moving upward to a 3½% pace by the end of 2000. But a growing share expect the cost of living to remain on an unusually modest growth path for the foreseeable future.

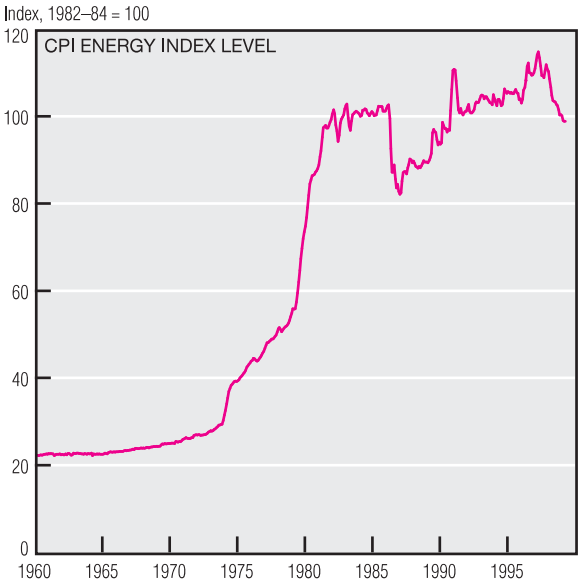
The precipitous drop in crude oil prices was one of the most important factors in containing the cost of living over the past few years. During the two-year span ending in 1998, oil prices fell more than half (from about $25 per barrel to just $11 a barrel). But prices rose early this year and are now back above $15 a barrel—a level that investors in futures believe will hold indefinitely.

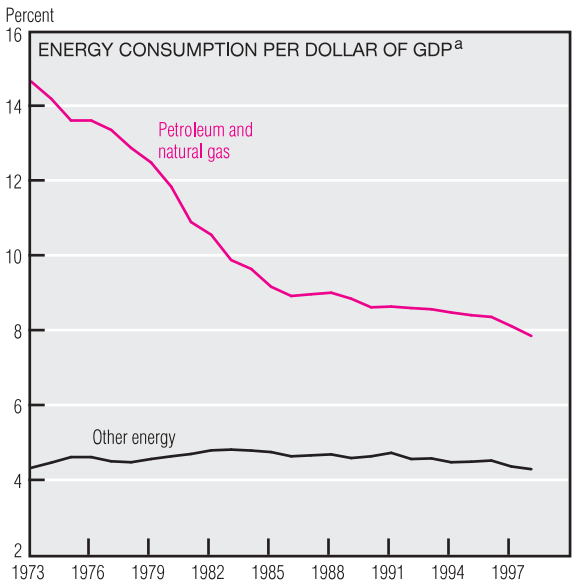
The recent upturn in oil prices results from OPEC's decision to cut production by 1.7 million barrels per day beginning April 1. Whether this move will have a lasting impact on oil prices is uncertain.

In the 1970s, OPEC drove up prices by orchestrating supply cuts in 1973–74 and 1978–79. But oil prices halted their upward climb in 1980 and struggled to hold level between 1980 and 1985. The oil cartel is problematic because there are huge

(continued on next page)

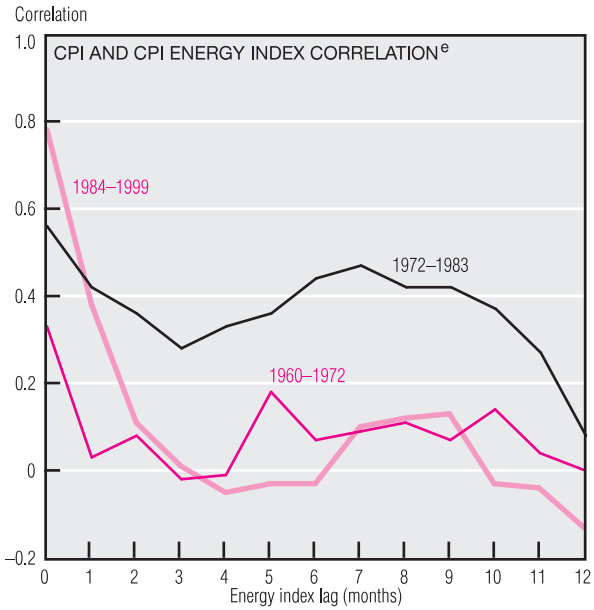
Inflation and Prices (cont.)





World Oil Production

	1998[a,b]	Percent of capacity[c]
OPEC	28,811	93
Saudi Arabia	8,415	85
Iran	3,638	60
Venezuela	3,179	94
United Arab Emirates	2,350	98
Iraq	2,136	61
Remaining OPEC	9,092	88
Non-OPEC	38,162	99
North America	11,395	86
United States	6,338	69
Russia[d]	5,931	78
China	3,197	100
Norway	3,025	96
United Kingdom	2,596	100
Remaining non-OPEC	12,018	100



a. 1998 data are estimated.
b. Thousands of barrels per day.
c. Estimate based on percent of highest annual production.
d. Production data start in 1992.
e. Correlation between CPI 1-month percent change and CPI energy index 1-month percent change, lagged from zero to 12 months.
SOURCES: U.S. Department of Energy, Energy Information Administration, *Monthly Energy Review,* February 1999; and U.S. Department of Labor, Bureau of Labor Statistics.

incentives for producers to take advantage of inflated prices with higher production, and for consumers to reduce their consumption. In a failed effort to maintain high oil prices, OPEC (particularly Saudi Arabia) sharply cut production throughout the early 1980s. By 1985, energy conservation efforts in the U.S. and elsewhere had drastically reduced dependence on petroleum; between 1973 and 1983, for instance, petroleum and gas consumption as a share of U.S. GDP was reduced about one-third.

Several times in the past 15 years OPEC has tried—and failed—to prop up sagging oil prices. The recent agreement is no more certain to succeed. Indeed, most nations are already producing at levels below their capacity (as evidenced by current production relative to their previous production peaks).

The inflationary consequences of this uptick in oil prices will largely depend on the Federal Reserve's behavior. Higher oil prices will cause retail prices to spike higher. But this is a one-time price level adjustment: It need not become a generalized, ongoing inflationary process unless the Federal Reserve "accommodates" oil price increases with an expansionary money stock. Simple statistical analysis suggests that in the 1970s, energy price spikes tended to be accommodated (the correlation between CPI changes and energy price changes persisted for at least a year). Prior to 1972 and since 1983, energy price increases have tended to cause a spike in the CPI for a month or two, but their effect generally has been short-lived.